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No. 79-909

In the Supreme Court of the United States

OCTOBER TERM, 1979

RAYMOND E. SMITH, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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OPINIONS BELOW

The district court issued no written opinion. The court of appeals' order of affirmance is unpublished (Pet. App. 1-3).

JURISDICTION

The judgment of the court of appeals was entered on November 13, 1979. The petition for writ of certiorari was filed on December 11, 1979. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the government met its burden in establishing petitioner's opening net worth with reasonable certainty in this criminal tax evasion case prosecuted under the net worth method of proof.

STATEMENT

After a jury trial in the United States District Court for the Eastern District of Michigan, petitioner was convicted on two counts of willfully attempting to evade and defeat his income taxes for 1971 and 1972, in violation of 26 U.S.C. 7201.[1] The district court sentenced petitioner to one year's imprisonment and a fine of $20,000. The court of appeals affirmed (Pet. App. 1-3).

The government employed the net worth plus nondeductible expenditures method of proof. The evidence produced, and stipulated to by the defense, showed that during the prosecution years petitioner purchased real estate, automobiles, a boat, four racehorses, furniture and carpeting, and that his net worth apparently increased by $36,968.20 in 1971 and $31,268.33 in 1972 (A. 110a-112a).[2] After allowances for personal expenditures, tax deductions and credits, and various losses, the evidence adduced at trial showed that petitioner had understated his taxable income by $34,223 for 1971 and $32,158 for 1972 (A. 112a).

At the close of the government's case, petitioner moved for a judgment of acquittal on the ground that the government failed to investigate certain exculpatory leads (A. 97a-99a). The trial court denied the motion. It agreed with the government's submission that the leads were either not reasonably susceptible of being investigated or involved insignificant amounts of money (A. 106a-107a).

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[1]Petitioner was acquitted on a third count for 1973.

[2]"A." refers to the joint appendix filed in the court of appeals.

ARGUMENT

1. The net worth plus nondeductible expenditures method of proving income tax evasion is a well-established and judicially accepted method of prosecution in cases where the taxpayer's records are inadequate as a basis for determining income tax liability. Under the net worth method of proof, the government establishes the total net value of the taxpayer's assets at the beginning of a given year. Thereafter, the government proves the total net value of the taxpayer's assets at the end of that year and at the end of each succeeding year of the period under scrutiny, and computes the difference between the net values of the taxpayer's assets as of the beginning and end of each year. Nondeductible expenditures, such as living expenses, are added to the annual increases. If the resulting figure for any year substantially exceeds the taxpayer's reported taxable income for that year, the excess is treated as unreported taxable income, provided the government establishes a likely source of taxable income for the net worth increases or negates nontaxable sources for the net worth increases. *Holland* v. *United States*, 348 U.S. 121, 125-126, 137-138 (1954); *United States* v. *Massei*, 355 U.S. 595 (1958).

a. Petitioner contends (Pet. 12-13) that the government failed to establish his opening net worth with reasonable certainty, as required by *Holland* v. *United States*, *supra*, because it failed to investigate certain leads concerning cash accumulated during prior years that would have been sufficient to account for the apparent net worth increases during the prosecution years. In support of this argument, petitioner points to the testimony of Joseph Wilson, one of his fellow employees at Service Envelope Company. Wilson testified that petitioner told him in the year preceding the first prosecution year (with one exception) that he had made

enough money to retire for six or seven years;[3] that he could make $700 a night on the street; that he had $1,400 in cash on his person; that he had an interest in a photography shop; that he wanted to continue working at Service Envelope so that he would have a place to report his outside income; and that he had substantial racetrack winnings (A. 48a, 51a-53a, 62a-63a). Wilson also testified that on one occasion he saw petitioner with a large sum of cash (A. 61a).

There is, however, little in the record to establish that the information Wilson revealed in his testimony was made known to the Internal Revenue Service agent who investigated petitioner's tax liability (see A. 10a-16a, 46a-47a, 68a). Petitioner did not supply any leads to possible non-taxable sources for the net worth increases to the investigating agent (A. 100a-102a). Instead, petitioner's attorneys told the agent that the apparent net worth increases were attributable to expenditures from cash savings which petitioner had accumulated from continuous employment during pre-indictment years and to loans and cash gifts from family members (A. 10a-11a). The agent obtained petitioner's payroll information dating back to 1957, when petitioner began his employment. The agent determined that petitioner could not have saved enough from his wages to account for the increases in net worth (A. 8a-11a, 78a-79a). The agent also spoke to petitioner's mother and was told that she was not aware of any loans, inheritances, or gifts to petitioner (A. 11a).

The agent also testified that during his investigation he heard that the petitioner may have earned income renting Doberman Pinscher dogs to J.L. Hudson Co.,

[3]This statement was made on March 25, 1971, during the first prosecution year (A. 50a-51a).

but that the firm could not confirm that allegation for the agent (A. 12a). Finally, the agent testified that these were the only leads he received during the course of his investigation (A. 12a) and that he fully investigated those leads.[4] Accordingly, the investigating agent did not know the information in Wilson's testimony.

b. Even on the assumption that the information in Wilson's testimony was known to the government prior to trial, the government's failure to investigate that information would not have required a reversal. The government is only required to investigate leads that can reasonably be checked and that, if true, would establish the taxpayer's innocence.[5] *United States* v. *Ramsdell*, 450 F. 2d 130, 132 (10th Cir. 1971). Where there are no means of effectively investigating the leads (*e.g.*, names of potential witnesses, specific dates, records, *etc.*), the government is not required to investigate. *United States* v. *Ramsdell*, *supra*, 450 F. 2d at 132-133. In light of the

[4]The agent also testified that he did not interview anyone with whom petitioner was likely to have been associated prior to the prosecution years because he did not have the names of any such people, and that he did not interview anyone who had served with petitioner in the Army because he did not have petitioner's serial number, and petitioner's attorneys refused to supply it when he asked them to do so (A. 15a-16a).

[5]Another of petitioner's fellow employees, Walter Zub, testified, without specifying the years involved, that petitioner would lend money to his fellow employees in return for payment of 25 cents for each dollar loaned (A. 71a-72a). Zub never heard of anyone borrowing any more than $10 (A. 72a). Even assuming that the investigating agent was aware of this information prior to trial, the trial court correctly concluded that, at best, this evidence indicated the possible accumulation of only an insignificant amount of money (A. 107a)—which could not have accounted for the large increases in net worth and would not have been material to show petitioner's innocence.

vague unspecified nature of Wilson's testimony, the courts below correctly ruled that the government was not required to investigate these "leads" (Pet. App. 2).

2. Petitioner further argues (Pet. 15-20) that the government's proof was inadequate to show that the amount of cash on hand at the beginning of the prosecution period was insufficient to account for the net worth increases. But the investigating agent examined petitioner's payroll information dating back to 1957 and determined that petitioner could not have accumulated a cash hoard sufficient to account for the net worth increases during the prosecution years (A. 8a-11a, 78a-79a). This conclusion was corroborated by the fact that the petitioner worked substantial amounts of overtime prior to the prosecution years (A. 39a) and by petitioner's statements to Wilson, his fellow employee, made about three months before the first prosecution year, that he wanted a leave of absence so that he could get established in his own business before quitting Service Envelope, that he wanted something to fall back on if he did not succeed in his outside ventures, and that he would not be back to work if his outside ventures were successful (A. 48a, 53a). From this evidence, the jury could have reasonably concluded that petitioner had no outside source of income prior to the prosecution years to account for the subsequent increases in his net worth.

In short, petitioner was free to attempt to establish that he had a substantial amount of cash on hand at the starting point, and it was for the jury to resolve that factual question. *United States* v. *Mackey*, 345 F. 2d 499, 506 (7th Cir.), cert. denied, 382 U.S. 824 (1965); *Fowler* v. *United States*, 352 F. 2d 100, 107 (8th Cir. 1965), cert. denied, 383 U.S. 907 (1966). There was, however, ample evidence to support the conclusion that

petitioner had insufficient cash on hand at the beginning of the prosecution years to account for the net worth increases during the prosecution years.

In these circumstances, petitioner errs in his final argument (Pet. 21) challenging the government's use of a hyphen in its net worth computations to represent that petitioner had an undetermined amount of cash on hand that was insufficient to account for the large increases in his net worth during the prosecution years (A. 11a). *United States* v. *Giacalone*, 574 F. 2d 328 (6th Cir.), cert. denied, 439 U.S. 834 (1978). It is settled that exact precision as to cash on hand is not required in a net worth case. See, *e.g.*, *United States* v. *Carter*, 462 F. 2d 1252 (6th Cir.), cert. denied, 409 U.S. 984 (1972); *United States* v. *Bush*, 512 F. 2d 771 (5th Cir. 1975); *United States* v. *Mackey*, *supra*.[6]

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[6]Petitioner contends (Pet. 22) that the government did not establish a likely source of taxable income for the net worth increases. But by his own admission made on March 23, 1971, during the first prosecution year, petitioner was earning enough from his outside business ventures so that he would not have to work for six or seven years (A. 50a-51a).

CONCLUSION

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

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